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# China Stakes Claim for Global Oil Access

## In its quest for crude, Beijing is dangling cash and playing on nations' discontent with the U.S. Can the two huge energy consumers coexist?

By Mark Magnier
Times Staff Writer

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BEIJING — When Alberta Premier Ralph Klein toured China last year and invited business leaders to visit the Canadian province's oil sand deposits, he didn't expect an immediate response.

But when Klein returned home a week later, Chinese executives were already making the rounds in Alberta, where the oil sands region is roughly the size of Florida and is believed to contain the richest reserves after Saudi Arabia.

The executives' quick response paid off. Three of China's state-owned oil firms have since poured huge investments into the oil sands, including a 40% stake in a $3.6-billion project that will be able to send oil via a new pipeline to Canada's west coast for shipment to China and elsewhere.

"Clearly, China has been the talk of Calgary," said Steven Paget, an analyst for investment bank FirstEnergy Capital Corp. there.

Scenes like this are being repeated around the world. Dangling cash and access to its huge market, China is dispatching legions of diplomats, surveyors and engineers across the globe to help quench the Middle Kingdom's insatiable thirst for energy.

During the last two years, President Hu Jintao and Premier Wen Jiabao have taken oil executives on trips to oil-rich countries from Algeria to Uzbekistan to seal major deals. The government in Beijing has welcomed top officials from all 11 members of the Organization of the Petroleum Exporting Countries. A major point of a trip Hu made to Moscow this month was to secure access to Russia's vast reserves.

Chinese crews are building roads in Africa in exchange for the right to extract oil from remote regions. Viewers in Saudi Arabia, a nation that U.S. oil firms once had to themselves, now watch Chinese programs on satellite TV as China drills into Saudi sands. China is also taking advantage of tensions between the Bush administration and Venezuelan President Hugo Chavez to wrest oil from one of the largest U.S. suppliers.

To secure deals worth tens of billions of dollars, Beijing is cozying up to regimes in nations, including Iran and Sudan, that Washington labels pariahs. And it is flexing its military muscle to lay claim to contested fields in East Asia.

China's aggressive search is putting it in growing competition with the United States, the world's largest oil consumer. Some observers even warn of a possible showdown between the two economic giants.

"The Bush administration's attitude toward China at the moment is to look for ways to work with them, but I don't know how sustainable this policy is going to be," said Gal Luft, executive director of the Washington-based Institute for the Analysis of Global Security, a conservative think tank. "At the end of the day, you've got two very large consumers competing over the same sandbox. Sooner or later the Chinese are going to run out of places they can look for oil."

China says wealthy countries need to adapt. It notes that those countries have been the largest energy users for a century despite accounting for just 15% of world population. It also insists that its appetite for foreign oil does not challenge U.S. interests or global stability.

"China was never, is not and will not pose a threat to world energy supplies," Ma Kai, China's energy chief, said in Beijing.

Still, U.S. concerns over China's recent forays grew last month after CNOOC Ltd., which is 71% owned by state-controlled China National Offshore Oil Corp., made an unsolicited $18.5-billion bid for El Segundo-based Unocal Corp. The House of Representatives passed a nonbinding resolution two weeks ago opposing the deal on national security grounds, prompting an angry response from Beijing.

"We demand that the U.S. Congress correct its mistaken ways of politicizing economic and trade issues," the Foreign Ministry said in a statement.

Before the Unocal bid, Beijing's activities had attracted relatively little attention from a U.S. administration focused on Iraq, Washington's war on terrorism and other foreign policy priorities.

"We're still trying to get a handle on what's happened on our watch," said a senior State Department official who asked not to be identified because he was not authorized to speak on the record. "More work needs to be done on this."

Other analysts say the U.S. and other nations must adjust to China's new role as a major global energy player. "The bottom line is, the U.S. will have to make room for China," said Youssef M. Ibrahim, an oil analyst with Strategic Energy Investment Group of Dubai, United Arab Emirates. "If it doesn't make room for China, China will take the room."

As mammoth tankers the length of three football fields line up at Chinese ports to dump their loads, it's difficult to believe that just a dozen years ago, China was self-sufficient in oil. The discovery of the giant Daqing field in the late 1950s created a windfall that turned the then-isolated communist nation into East Asia's biggest oil exporter. While Americans were lining up for gasoline, the largely agrarian country sailed unscathed through the 1970s oil shocks.

In 1985, Chinese newspapers gave front-page coverage to the first farmer who bought his own truck. The country was in the early stages of an economic boom that would see rice fields give way to bustling factories spitting out Barbies and computers for the world's consumers. Guangdong province alone boasts more than 60,000 factories producing $300 million worth of goods a day.

Today the nation of 1.3 billion people has 20 million vehicles, a figure expected to grow sevenfold in the next 15 years.

Since the early 1990s, China's oil consumption has grown 7.5% a year, seven times America's growth rate, forcing the nation to go looking overseas for new supply. By 2030, China is expected to need 13 million barrels of foreign oil a day, roughly equivalent to current U.S. import levels, to fuel its cars and power its factories.

Most factories in China use state-produced electricity, which is generated largely by coal. But the electric grid often suffers blackouts, putting a strain on firms rushing to finish orders.

Factories in Dongguan, a gritty industrial city in the southern province of Guangdong with little charm and lots of teenage workers, respond to the endemic power shortages by making their own. That helps explain why China recently surpassed the U.S. as the world's biggest buyer of industrial generators.

Local governments across the industrial belt employ phone trees and cellphone text-message systems to warn of impending blackouts. As the alerts spread, industrial generators sputter to life. If the warning arrives late, manufacturers must dump partially finished goods.

But the new machines demand fuel, spurring competition for diesel. With legal diesel in short supply, managers such as Xia Jianhua of trucking firm Oriental Transportation turn to the black market, buying it for $2 a gallon, 30 cents over the official price.

Xia said high fuel costs had sliced his profits 20%. "The government should do something as soon as possible," he said.

Some economists say authorities should cut fuel subsidies and raise prices to limit consumption. Although the Communist Party has begun to make industrial users pay more for their fuel, it has resisted price hikes for farmers or residential users, fearing social upheaval.

As new jobs and exports create a burgeoning middle class, a nation that once relied on bicycles to get around is gobbling up new cars, which guzzle foreign oil.

Li Jia, a 24-year-old hotel clerk in Beijing, bought his white Kia for $10,000 two years ago. Most of his colleagues, also in their 20s, own cars. "I like the convenience and the color," Li said. "I'm worried about high gas prices, but what can you do?"

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In his gleaming office overlooking Beijing's traffic snarls, Yang Hua, chief financial officer for CNOOC, fingers small vials labeled "Light Sweet," "Synthetic Crude" and "Tailings Sand" on his windowsill. He's focused on one objective: enabling his company to find enough oil to strengthen its competitive position and help satisfy China's energy needs.

As a petroleum engineer with CNOOC, Yang has searched for oil in Iran, Kazakhstan, Qatar, Yemen, Brazil, Tunisia, Indonesia and the roaring waters of China's Bohai Bay.

"We usually have to work in some pretty harsh environments," he said.

As CFO, Yang has had to court Wall Street. Annual reports and balance sheets have replaced seismic charts in his office.

"China seems to have almost unlimited demand," he said. "As an energy supplier, we feel ashamed of not having enough energy for the market. But, of course, it's great for business."

The Unocal bid represents the largest foreign acquisition attempted by a Chinese company. But the offer is meeting growing resistance in Washington, raising the odds that it won't be approved.

"I think it would be terribly foolish if they just come in here and buy Unocal," said Rep. Robert W. Ney (R-Ohio). "Overnight, they could have gas to three bucks [a gallon] at the pump."

To secure energy for current and long-term needs, CNOOC and other Chinese firms have pursued a bold strategy: Court oil-rich nations Washington considers pariahs. China moves in when U.S. policy keeps ExxonMobil, Chevron-Texaco and other American companies from drilling in Iran, Sudan and elsewhere.

"They have to go where Western oil companies aren't," said Michael Lelyveld, senior analyst for PFC Energy, a Washington-based consulting firm.

China trades on an asset these countries value: its veto power as a permanent member of the United Nations Security Council.

Beijing has reportedly threatened to veto any U.S. attempt to impose sanctions on Iran for pursuing uranium enrichment technology in what Washington alleges is a nuclear arms program. China has also sold Iran weapons, including long-range missile technology, that could threaten shipping in the Strait of Hormuz, through which 40% of the world's oil exports flow.

In October, Beijing used its friendship with Tehran to seal a $70-billion agreement giving Chinese companies a 51% stake in the huge Yadavaran oil field, Iran's largest onshore field, along with a promise to help develop the largely untapped area.

"With the current U.S. threat to refer Iran's nuclear case to the U.N., Iran needs friends in high places," said Reza Zandi, an energy expert and journalist for Iran's Sharq newspaper. "We want to be friends with 'big China,' and they want to be friends with us."

Deputy Iranian Oil Minister Seyed Mohammed Hadi Nejad Hosseinian said U.S. pressure had driven Iran into China's arms.

The U.S. Energy Department recently opened an office in Beijing, partly to discuss conservation and China's oil quest. U.S. officials also hope high-level dialogue will address Beijing's dealings with Tehran.

Friction between Washington and Beijing has also surfaced in Sudan, where state-held China National Petroleum Corp. has a 41% stake in Petrodar, a major Sudanese oil consortium. Sudan's relatively small production is expected to reach 500,000 barrels a day this year.

In September, Beijing frustrated a U.S.-led bid to impose tough U.N. sanctions against Sudan after government-backed militias committed atrocities against the non-Arab population in the Darfur region.

Sudanese Information Minister Abdel Basit Sabdarat said the U.S. had pushed Khartoum to limit its ties with Chinese oil companies. "But we refuse such pressures," he said. "Our partnership with China is strategic. We can't just disband them because the Americans asked us to do so."

When Uzbek President Islam Karimov arrived in Beijing nearly two months ago, Chinese greeters handed him a lavish bouquet and guided him across a bright red carpet as Chinese oil executives waited in the wings to sign a $600-million joint venture.

"This is an important step for energy cooperation," Karimov told the People's Daily, the Communist Party's newspaper.

Weeks before Karimov's visit, Uzbek troops fired on protesters in Uzbekistan's Andijon area, resulting in 700 deaths, according to human rights groups. The government disputed that figure, saying only 187 people died, most of whom were "lawbreakers."

After the clashes, Beijing promptly said it would oppose any U.S. or European calls for a U.N. inquiry, describing the Uzbek crackdown as a justifiable move against "terrorism, separatism and extremism."

In many parts of the developing world, China has made friends by avoiding the sort of finger-wagging of which Washington is sometimes accused.

"The Chinese don't get involved with religion, they don't get involved with political democracy arguments," said Hassan Husseini, a longtime oil consultant in Saudi Arabia.

"On the subject of women, they accept, and we accept, that we're different," he said. "They're very technically competent and they stay out of politics."

Han Wenke, deputy director-general of the Chinese government-supported Energy Research Institute, said Beijing did not need to apologize for striking deals with governments out of favor with Washington.

"This is just an economic relationship, not political or military cooperation," he said. "Another thing, I don't think China needs to follow the U.S. policy."

Other observers note that the U.S. does business with nations such as Saudi Arabia, which is often cited for torture and other human rights abuses. Human rights groups have criticized some U.S. oil companies for dealing with leaders who repress their people and siphon oil revenue into foreign bank accounts.

Drew Thompson, a China analyst at the Center for Strategic and International Studies in Washington, said that "in some ways China is being held to a different standard than other countries."

"If there's a military dictatorship in Nigeria or less than free and fair elections, does that mean that ExxonMobil or Shell do not do business with them?" Thompson asked.

Besides diplomatic clout, China offers low-interest loans and promises of better roads and other aid that Western oil companies typically don't.

Beijing has won friends in Africa with big gestures, including a $1.2-billion, continentwide debt-forgiveness program.

It has also addressed the needs of individual countries.

In the slums of Luanda, the capital of oil-rich Angola, residents living amid garbage and open sewers have witnessed the march of modern electricity pylons through their neighborhood, thanks to the Chinese. A few miles away, on the city's outskirts, a modern village is set off from the surrounding shacks by a security fence, built to house government officials. It too was a gift from the Chinese.

Chinese-built roads, bridges and railroad installations are on the drawing board, part of a $2-billion infrastructure loan program Beijing signed with the country last year in return for oil.

Angola, which is China's second-largest supplier after Saudi Arabia and accounts for about 300,000 barrels a day, may be one of the biggest African recipients of China's largesse, but it's hardly alone. China's African footprint is growing — from the blue Chinese tiles adorning autocratic Zimbabwean President Robert Mugabe's palace roof and the smooth blacktop roads snaking across Rwanda to the new railways in Nigeria and a high-profile port project in Gabon.

The Chinese do what it takes to "lubricate their way into foreign oil deals," said Luft of the Washington-based think tank.

President Hu's visit to Gabon in February 2004 helped Chinese companies secure an onshore oil exploration deal and a promise to be sold a significant amount of crude.

Even in countries such as Nigeria where China is shut out by Western firms, it has displayed patience, hoping over time to partner with or replace them when drilling licenses come up for renewal. Beijing announced this month that it would build and launch a communication satellite for Nigeria by 2007.

Even as America has become increasingly critical of Saudi Arabia's government on democracy and terrorism issues, China has courted the kingdom with everything from soccer matches to tourism.

In recent years, the Saudis have opened an office of the state oil company, Aramco, in Beijing and a consulate in Hong Kong and this month invested in a refinery in southern China. Beijing has also hinted at a deal to grant Aramco access to its huge retail gasoline market in return for guaranteed supply.

Today, *dishdashas*, the traditional white robes worn by Saudis, are mostly made in China, and cable channels in the kingdom broadcast Chinese programs. "I love to watch Chinese humor subtitled in English," said Husseini, the oil consultant. "It's so funny."

China's oil needs also mean it must venture off beaten paths. Sometimes, that means moving into the United States' backyard. Chinese firms have been able to capitalize on discontent with Washington in Ottawa and Caracas.

U.S.-Canadian relations have been strained in recent years by disagreements over the Iraq war, missile defense and U.S. restrictions on Canadian lumber and beef. In granting China access to its oil sands, Canada sends a message that the U.S. isn't the only game in town. The move also helps diversify the nation's customer base.

China's investments in Canada began slowly, with a $124-million stake by CNOOC in MEG Energy, a small, privately held company with a proprietary oil sand technology. PetroChina International signed a deal to participate in the billion-dollar pipeline project that would help bring the oil sand output to West Coast tankers.

The bitumen found in oil sand is a sticky deposit that must be converted into crude before it can be refined into gasoline or other fuels. Extracting the bitumen is expensive, but experts say it can be profitable, especially with oil prices in the neighborhood of $60 a barrel. Production is expected to jump from the current 1 million to 3 million barrels a day within a decade.

China has also benefited from dissatisfaction with the U.S. to the south. Analysts say Venezuelan President Hugo Chavez has used his growing partnership with Beijing as a way to poke Washington in the eye — Caracas says China will help Venezuela diversify its customer base.

During a visit to Beijing last year, Chavez pledged energy assistance to China. And in a reciprocal visit in January by Chinese Vice President Zeng Qinghong, Venezuela promised 100,000 barrels of oil a day and 3 million metric tons of fuel oil a year. No investment figures were given, but a competing bid valued a similar deal at $6 billion.

It's unclear, however, when the shipments will begin or if they will affect delivery obligations to U.S. refineries. The U.S. imports 1.3 million barrels a day from Venezuela, about two-thirds of that nation's output.

This month, China said it would boost Chavez's social programs by using Venezuelan workers to build 10,000 houses on state-owned land in Venezuela in the next two years.

Disillusionment with the United States has also provided China with openings in Brazil, where Beijing and Brasilia are collaborating on projects to develop hydroelectric power and natural gas.

"The U.S. is not … giving attention to the strategic partnership with Brazil," said Luiz Fernando Furlan, Brazil's minister of development, industry and foreign trade. "We cannot stay free waiting for what Washington decides."

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U.S. officials stress that they have no intention of blocking China's search for oil.

"We're not going to go across the globe trying to head off China every time we see them going after natural resources," said the State Department official.

Karen Harbert, assistant secretary of Energy for policy and international affairs, says Beijing's quest does not pose a "threat to U.S. interests or a threat to U.S. companies."

But it is expected to figure prominently in a U.S.-China dialogue scheduled for this month, led on the U.S. side by Deputy Secretary of State Robert B. Zoellick.

U.S. officials say China's reliance on energy from far-flung sources has led it to seek political stability in some regions and safety on the high seas — goals that dovetail with Washington's.

Harbert said the administration was stepping up efforts to work with China, other major energy consumers and oil-producing nations to ease supply problems. Some critics, however, say the administration should better safeguard U.S. national interests and manage tensions.

"In order to sustain this economic growth, emerging economies such as China and India will need more and more supplies of energy and minerals," Rep. Jim Gibbons (R-Nev.) told a congressional panel in March. "The United States must take a serious look at its energy and mineral supply strategy for the long term."

But although officials in both countries emphasize coordination, some analysts say China's hunt for oil could lead to a clash with the United States.

"The competition for oil could lead to armed conflict, particularly with China," Milton Copulos, president of the conservative National Defense Council Foundation, told a House hearing on global energy in March. "Lest this statement seem alarmist or farfetched, I would note that the Chinese are, for the first time, developing a blue-water navy capable of operating beyond their shores."

Defense Secretary Donald H. Rumsfeld echoed those concerns when he addressed a recent Asian security conference in Singapore. He said that China's military expenditures placed it first in Asia and third in the world, and added: "Since no nation threatens China, one must wonder: Why this growing investment?"

Some critics fear that, as its global clout grows, China will begin challenging the U.S. for military influence in Asia, a scenario Beijing rejects.

Analysts say China's crash program to expand its navy is aimed largely at building a credible threat that would deter Taiwan from declaring independence. Some add that a secondary aim is to expand its presence in the Strait of Malacca, the pirate-infested bottleneck off Malaysia through which more than 60% of its oil imports flow.

Beijing says it has neither the will nor the ability to challenge the U.S. militarily and only wants to develop peacefully.

But the U.S. and China's neighbors worry that Beijing, if faced with shortages, could use its military to grab oil-rich marine fields. Tensions have flared with Japan over mineral rights in disputed islands in the East China Sea. China has used gunboats to force Japanese seismic ships out of the area. And analysts say a Chinese submarine caught on the Japanese side last year was testing Tokyo's vigilance in the resource-rich area.

China is also seeing growing friction over resources with some of its neighbors as its regional power expands. Taiwan has repeatedly chased off Chinese research vessels doing resource surveys in disputed waters off islands variously claimed by Taiwan, Vietnam and China.

"Our efforts haven't prevented survey ships from coming back," said Shi Hwei-yow, director-general of the Taiwanese Coast Guard.

Farther south, China said it had rights to the disputed gas- and oil-rich Spratly Islands in Southeast Asia, also claimed variously by Malaysia, the Philippines, Taiwan and Vietnam. In a bid to break the logjam, China early this month called for joint exploration to exploit some of the Spratly resources.

China increasingly has turned to Russia and its Central Asian neighbors. Russia and China are discussing a 1,500-mile, $2.5-billion pipeline that would supply 700 million tons of Russian crude over 25 years. And Beijing and Kazakhstan recently agreed to work on a $2.5-billion pipeline able to transport 20 million tons of oil a year to western China.

Since it began importing oil in 1993, China has intensified energy exploration abroad, especially in the last few years. It now boasts investments in dozens of oil and gas projects in 30 nations. CNOOC is the most Western of the Chinese oil giants, with USC- and MIT-educated, English-speaking senior managers. The firm has recruited former Secretary of State Henry A. Kissinger and international business leaders to sit on its advisory board.

Analysts say Chinese oil executives, who are beholden to the Communist Party, are not bound to follow the rules of the market. Beijing disputes that.

"Why are other countries' oil imports justified, but it is called 'a threat' when it comes to China?" Zhang Guobao, deputy minister of the National Development Reform Commission, asked at a Beijing forum in May.

The fact that China has paid top dollar for projects rejected by Western oil companies has left some analysts shaking their heads about what they see as Beijing's willingness to shell out too much for too little.

Harbert, the U.S. Energy undersecretary, said China's large state-owned energy firms had a "different risk profile" than U.S. companies that must answer to shareholders.

"Just by that difference in purpose, [Chinese firms] have the ability to go into areas where private-sector companies cannot bear that risk," she said.

Some of China's more far-flung deals, such as in Venezuela, reflect a "politically driven panic" to secure any source of crude oil without much regard to practical issues such as transportation and refinery capabilities, said Mikkal Herberg, an oil expert at the National Bureau for Asian Research in Seattle.

"The Chinese are in the mode to pay for supply security … and the economics come secondarily," he said.

Others say Chinese oil companies are ill-prepared for the future, lacking the technology to compete for deep-water drilling projects, which will make up the bulk of future oil exploration. A Unocal takeover could expand their expertise, however.

Ma Xiaoye, a former Chinese trade official and now head of the Academy for World Watch, an independent civic group based in Shanghai, said the country must better coordinate its efforts.

"I can't see in the foreseeable future that China will act like the U.S. with military, political, diplomacy tied to oil security," he said. "China is not that sophisticated. We are not that prepared."

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Seeking oil abroad

China's growing demand for oil has led it to look overseas for new supplies. A sample:

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- Canada: Granted access to oil sands in Alberta, considered the richest reserves outside Saudi Arabia; has 17% stake in Calgary firm with proprietary oil sands technology.

- El Segundo: CNOOC Ltd. made an unsolicited $18.5-billion bid for Unocal Corp.

Indian Ocean

- Nigeria: New railways funded by China.

- Gabon: China paying for port project.

- Angola: China's second-largest supplier is among the African nations benefiting financially in return for oil. Projects include electricity for Angolan slums.

- Russia: In talks for a 1,500-mile, $2.5-billion pipeline to supply 700 million tons of Russian crude over 25 years.

- Sudan: Its largest oil investor is China, which holds a 41% stake in a major Sudanese oil consortium.

- Kazakhstan: A $2.5-billion pipeline to western China is due for completion this year; it will be capable of transporting 20 million tons of oil annually.

- Iran: Chinese companies spent $70 billion for a majority stake in the nation's largest onshore oil field. China has also promoted relations by selling weapons to Iran.

- Saudi Arabia: China's largest oil supplier has a consulate in Hong Kong and a Beijing office for its state oil company.

- Rwanda: Road projects funded by China.

- Myanmar: Officials negotiating to build oil and natural gas pipelines from northern Myanmar to southwestern China.

- Strait of Malacca: The pirate-infested bottleneck off Malaysia through which more than 60% of China's oil imports flow.

- Spratly Islands: China called this month for joint exploration in the disputed islands near the Philippines.

- Philippines: State oil companies reached a deal in 2004 to research oil in the South China Sea.

- Indonesia: Third-largest oil and gas producer is also China's largest offshore oil producer. Will provide liquefied natural gas to fill a new terminal in Guangdong province.

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Sources: Times reporting; ESRI; http://www.nelsonresources.com

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*Contributing to this report were Times staff writers Evelyn Iritani in Calgary, Robyn Dixon in Luanda, Tyler Marshall in Washington, Carol J. Williams in Caracas, Don Lee in Shanghai and Megan K. Stack and Hossam Hamalawy in Egypt. Also contributing were special correspondents Thomas Erdbrink in Iran, Alexei V. Kuznetsov in Russia and Tsai Ting-I in Taiwan.*